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BEFORE THE ARIZONA CORPORATION COMMISSION

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SUSAN BITTER SMITH

IN THE MATTER OF THE COMMISSION'S IN-  
QUIRY INTO RETAIL ELECTRIC COMPETI-  
TION

DOCKET NO. E-00000W-13-0135

**NOTICE OF FILING  
RESPONSIVE COMMENTS OF  
TUCSON ELECTRIC  
POWER COMPANY AND  
UNS ELECTRIC, INC.**

Tucson Electric Power Company and UNS Electric, Inc., (collectively "Companies") through undersigned counsel, hereby file comments in response to the May 23, 2013 Letter from Executive Director Jodi Jerich in this docket. Should other interested parties raise new issues not set forth in their initial filed comments, the Companies reserve the right to file supplemental responsive comments to address such issues.

RESPECTFULLY SUBMITTED this 16<sup>th</sup> day of August 2013.

TUCSON ELECTRIC POWER COMPANY  
UNS ELECTRIC, INC.

By [Signature]

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and

Arizona Corporation Commission  
**DOCKETED**

AUG 16 2013

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15 this 16<sup>th</sup> day of July 2013 to:

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7 Service List for Docket No. E-00000W-13-0135

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*Mary Appolito*

**Tucson Electric Power and UNS Electric, Inc.**  
**Joint Responsive Comments**  
**In the Matter of the Commission's Inquiry into Retail Electric Competition**  
**Docket No. E-00000W-13-0135**  
**August 16, 2013**

Tucson Electric Power ("TEP") and UNS Electric, Inc. (the "Companies") hereby offer the following responsive comments regarding the prospects for retail electric competition in Arizona, a topic currently under consideration by the Arizona Corporation Commission (the "Commission") in Docket No. E-00000W-13-0135.

As discussed more fully in the Companies' comments filed on July 15, 2013, it is difficult to envision how retail electric competition would benefit Arizona. Our residents and businesses already enjoy low electric rates and high service reliability from traditionally regulated local utilities with strong customer satisfaction rankings. This success stands in stark contrast to the experience of states that have adopted retail electric competition, where higher average rates and looming energy shortages are all too common.

Against this backdrop, would-be power providers and some of the large commercial and industrial customers they might serve have joined free-market academics in laboring to prove in their comments to the Commission that the theoretical benefits of retail electric competition might be realized here in Arizona. In this, they have failed. The aggregated evidence in this docket makes clear that the risks and costs of transitioning to such a market far outweigh its potential benefits, particularly in a state so utterly lacking the problems that retail electric competition was intended to solve.

If the Commission authorizes such a transition, it would unnecessarily place Arizona residents and businesses at risk of higher, more volatile rates and dwindling energy reserves while sacrificing authority over Arizona's grid and resource mix to elected officials in Washington D.C. and/or California. Even the Commission's consideration of this prospect has clouded Arizona's regulatory climate in many ways while complicating the long-term resource planning needed to ensure the stability of our future energy supply.

In their comments to the Commission, supporters of retail electric competition have sought to sidestep, minimize or ignore shortcomings of their proposal. The Goldwater Institute, for example, dismisses concern over prudent energy reserves as "inefficient," a position not likely shared by the families and businesses that depend on safe, reliable power in Arizona's blistering hot summers.<sup>1</sup> When faced with conflicting research into the rate impacts of retail competition, the Compete Coalition opts to ignore that evidence and claim clear benefits for all customer classes based on a single, self-serving Power Point slide that

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<sup>1</sup> Goldwater Institute and Roy Miller's Comments in Support of Restructuring Arizona's Electricity Markets for Choice and Competition, Exhibit 2, Goldwater Policy Brief No. 259, at page 3

cobbles together a carefully constructed, overly optimistic picture.<sup>2</sup> Other advocates highlight the reasonable rates available this year in Texas without noting that, over the preceding decade, retail competition has cost that state's residents an estimated \$10 billion in excess power expenses.<sup>3</sup> Proponents also conveniently ignore the significant fines imposed for energy market manipulations and the risk of similar schemes in a restructured Arizona electric market.<sup>4</sup>

The risks posed by retail electric competition are far more easily seen than its supposed benefits. A diverse group of parties including the AARP, low-income customer advocates, local government officials, investor representatives, environmental groups and the Navajo Nation have joined TEP, UNS Electric and other stakeholders in raising serious concerns about the prospect of a restructured energy market. Unburdened by the profit motives and philosophical zeal of advocates, these stakeholders clearly identified for the Commission the pragmatic problems that have plagued other states with competitive retail electric markets, including steep transition expenses, diminished energy reserves and a shifting of costs from the large customers "cherry-picked" by competitive providers to more vulnerable customer groups. In light of such widely understood risks as well as the legal and Constitutional obstacles, the Commission should promptly end its inquiry into retail electric competition and remove the cloud of uncertainty hanging over Arizona utilities by reaffirming its commitment to the traditional regulatory model that is already proven to deliver positive results for Arizona residents and businesses.

### **Unproven Promises of Savings**

In theory, restructured electric markets can lead to lower rates by forcing providers to compete for the right to serve customers. In practice, though, the heavily regulated, supply-constrained "markets" in states with competitive retail access have not produced clear, quantifiable price benefits for customers in all classes. As noted in the Companies' original comments, academic research into this question has produced mixed results. Although the Companies cited several studies that found retail competition has led to higher rates, we reiterate our position that the available research does not, in aggregate, provide convincing evidence that retail competition leads to lower electric bills.

Such caution was not reflected in the comments of many retail competition advocates, who offered bold promises of savings backed by a heavily filtered sample of the figures and findings that support their cause. For example, the National Energy Marketers Association's

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<sup>2</sup> Comments of the Compete Coalition, Attachment 2, "States with Restructured Electricity Markets Post Lower Rates of Change."

<sup>3</sup> *Deregulated Electricity in Texas: A History of Retail Competition*, Texas Coalition for Affordable Power, December 2012, at page 4

<sup>4</sup> The Companies' initial comments included several examples of recent market manipulation fines. Then, on July 16, 2013 – one day after initial comments were due in this docket – the Federal Energy Regulatory Commission ("FERC") ordered Barclays Bank PLC and four of its traders to pay \$453 million in civil penalties for manipulating electric energy prices in California and other western markets. Two weeks later, FERC approved a settlement agreement under which JP Morgan Ventures Energy Corporation will pay \$410 million in penalties and disgorgement to ratepayers for alleged energy market manipulations in California and the Midwest.

boast that “consumers in other states have already received significant price savings” cites current Texas rates without noting the above-average rates paid by customers of that state’s competitive providers over the preceding decade.<sup>5</sup> The Goldwater Institute offers a similar omission in its own praise for current Texas rates and then compounds the misleading effect by comparing an unsubstantiated reference to a single, “lowest cost Texas plan” to average retail rates in Arizona.<sup>6</sup>

Some advocates simply ignored inconvenient facts in favor of broad, unsubstantiated claims of lower prices. Wal-Mart, for example, offers no evidence to support its assertion that “other states that have moved to competition have shown that the entire electric marketplace has become more efficient and less costly.”<sup>7</sup> The statement ignores the significant expense of transitioning to a competitive market, including the cost of creating or joining an Independent System Operator (“ISO”) or a Regional Transmission Organization (“RTO”) and the accelerated recovery of utility investments made in reliance of a continued obligation to serve all customers within an exclusive franchise area – so-called “stranded costs.”

The Compete Coalition, meanwhile, sought to avoid the ambiguity of the available research by citing only its own, uniquely optimistic analysis of retail competition’s supposed rate benefits. They present their findings in simplistic bar graphs that appear to suggest that, between 1997 and 2012, average electric rates fell 4 percent in restructured states while increasing 7 percent in traditionally regulated states. But that conclusion is misleading, since the analysis adjusts actual rates to reflect changes in the prices of other consumer goods. The analysis also fails to exclude the uniquely expensive energy markets of Hawaii and Alaska, as has typically been done in more reputable research. Such dubious tactics do not provide the Commission with a fair picture of how retail competition has affected rates, particularly in isolation from all other peer-reviewed research on the topic. Indeed, a less biased analysis of the same data – price information from the U.S. Energy Information Administration, excluding Alaska and Hawaii – produces much less flattering results:

- Between 1997 and 2012, residential rates increased by an average of 3.37 cents in restructured states – 8 percent more than the 3.11 cent average increase in traditionally regulated states.
- In 2012, the average residential rates in restructured states were 34 percent higher than those in traditionally regulated states. Average monthly residential bills in restructured states were \$110, compared to \$82 in traditionally regulated states.

Of course, the Companies would not suggest that these points alone provide conclusive evidence regarding the rate impact of retail competition. But such data, combined with the research submitted by others who have raised concerns about restructuring, suggest that

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<sup>5</sup> Comments of the National Energy Marketing Association comments, at page 3

<sup>6</sup> Goldwater Institute and Roy Miller’s Comments in Support of Restructuring Arizona’s Electricity Markets for Choice and Competition, at page 3, lines 4-6

<sup>7</sup> Wal-Mart Stores, Inc.’s Initial Comments at page 3

retail competition advocates have failed to provide clear and convincing evidence that their proposal would reduce rates for all classes of customers in Arizona.

### **Cherry Picking Problems**

Supporters of retail electric competition also failed to rebut a key concern about rate impacts raised by the Companies and others: that “cherry picking” of large commercial and industrial customers would increase service costs and boost rates for residential customers and small businesses. Comments from the Retail Competition Advocates/Retail Energy Supply Association seek to dismiss this concern as “The Zero-Sum Game Fallacy” but address only issues with “stranded” costs – not the ongoing system costs that would be shifted to smaller customers in a restructured market.

In fact, retail competition proponents have only heightened concerns about this critical issue. A simple comparison of the parties that filed comments in favor of competition (primarily large commercial and industrial customers and the out-of-state providers who seek to serve them) with those who weighed in against the prospect (including AARP and low-income customer advocates) effectively identifies the likely winners and losers in such a market. Meanwhile, Freeport McMoRan and Arizonans for Electric Choice and Competition (“AECC”) freely acknowledge the disparate impact of competition in their joint comments: “Subsidy paying classes that pay rates above cost of service will likely experience a greater potential for savings, whereas subsidy-receiving classes will have less potential for savings.”<sup>8</sup> Such language is thinly disguised code for the real message: large, industrial customers would be winners under such a scheme, while everyone else will be losers. This point is reinforced by the fact that the majority of would-be power providers seeking Certificates of Convenience and Necessity (“CC&Ns”) in Arizona have requested access only to areas served by Arizona Public Service (“APS”), Salt River Project (“SRP”) and TEP – areas where the largest customers can be found.<sup>9</sup>

### **Direct Access Difficulties**

The more limited direct access proposal suggested in the comments of Freeport-McMoRan and AECC bears additional scrutiny. Although the proposal exceeds the scope of the Commission’s considerations in this docket, it would effectively institutionalize the most inequitable aspects of retail electric competition by allowing large commercial and industrial users to secure generation service from third-party providers. Although customers in other classes also would be allowed to participate, only large users could expect to seek out benefits and realize meaningful savings from such a system. Because cost-of-service rates would remain in place for other customers, the fixed utility system costs that might have been recovered through energy sales to those departed direct-access customers would necessarily be shifted to other customers.

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<sup>8</sup> Freeport-McMoRan Copper & Gold Inc. and Arizonans for Electric Choice and Competition Initial Comments and Response to Staff’s May 23, 2013 Letter Concerning Electric Retail Competition at page 4, lines 10-12

<sup>9</sup> Direct Energy Services, Constellation New Energy and Noble Americas Energy Solutions, LLC/Sempra Energy Solutions have requested CC&Ns to serve only the state’s most heavily populated service territories.

While a more limited direct access program and a similar proposal by Sun Edison to expand APS' AG 1 tariff, would create less upheaval than a transition to a fully competitive retail electric market, their implementation would first require the creation of new rate structures for all participating utilities. Such proposals also would severely compromise the Commission's Integrated Resource Planning ("IRP") process by creating uncertainty about the load that might be served by direct access providers in future years. Regulated utilities would need to ensure the availability of enough resources to serve all customers in their service territories, since direct access customers might switch back to utility generation service. Because direct access customers would not be paying for these additional reserves through generation rates, the costs borne by other utility customers would most certainly rise.

### **Ducking Concerns about Energy Reserves**

The dwindling energy reserves in Texas, New England and other states with restructured markets represent a glaring, real world failure of the appealing theories used to promote retail electric competition. Just one day after proponents filed testimony encouraging this Commission to entrust Arizona's long-term resource planning to free market forces, ISO New England issued a press release urging customers in competitive retail electric markets in Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont to conserve energy in order to avoid energy shortages during hot summer weather.<sup>10</sup> Energy supplies are also perilously tight in Texas, a state many advocates cite as the best model for a restructured Arizona market. On May 1, 2013, the Electric Reliability Council of Texas ("ERCOT") warned that it would likely "initiate conservation alerts or power watches on some days" this summer to "ask the public to reduce electric use to help ERCOT maintain reliability of the grid."<sup>11</sup>

While such warnings made headlines in newspapers across the country, they were conspicuously absent from the comments filed by competition proponents here. Even after the president of NRG Energy's Gulf Coast Region warned Houston Chronicle readers in June about the prospect of summer blackouts due to that state's dwindling energy reserves<sup>12</sup>, his company filed comments urging this Commission to embrace the Texas model of restructuring – making no mention of the supply shortages.<sup>13</sup> More recently, NRG CEO David Crane warned investors that the development of new generating resources is

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<sup>10</sup> *ISO New England Requests Voluntary Electricity Conservation*, ISO New England Press Release, July 16, 2013, [http://www.iso-ne.com/newsiss/pr/2013/iso\\_new\\_england\\_requests\\_voluntary\\_electricity\\_conservation\\_final.pdf](http://www.iso-ne.com/newsiss/pr/2013/iso_new_england_requests_voluntary_electricity_conservation_final.pdf)

<sup>11</sup> *ERCOT expects tight summer conditions, long-term outlook shows improvement*, ERCOT news release, May 1, 2013, [http://www.ercot.com/news/press\\_releases/show/26433](http://www.ercot.com/news/press_releases/show/26433)

<sup>12</sup> Ragan, John, *Ragan: Time for Texas to add to state's electric grid*, Houston Chronicle, June 11, 2013, <http://www.chron.com/opinion/outlook/article/Ragan-Time-for-Texas-to-add-to-state-s-electric-4594395.php>

<sup>13</sup> Comments of NRG Energy Inc. Addressing Retail Electric Competition Issues at pages 7-8

proving to be “virtually impossible” for merchant power providers in competitive retail electric markets.<sup>14</sup>

The few restructuring proponents who bother to address resource adequacy offer only incomplete or misleading information. The Retail Competition Advocates and Retail Energy Supply Association report sunny news from this year’s resource assessment in the PJM Interconnection<sup>15</sup> without mentioning that regulators in two states served by that ISO – Maryland and New Jersey – have resorted to extraordinary measures to address generation shortfalls in their area.<sup>16</sup> The National Energy Marketers Association, meanwhile, misses the Commission’s point altogether and comments on T&D reliability, not resource adequacy.<sup>17</sup> Finally, the Goldwater Institute boasts that the development of new generation in Texas has outpaced growth of the state’s gross domestic product without mentioning that most of those gains come from federally subsidized, intermittent wind resources<sup>18</sup> that haven’t staved off the growing risk of summer power outages.

### Whistling in the Dark

The Goldwater Institute, a staunch advocate for free-markets, at least deserves credit for philosophical consistency in adopting a Laissez-faire attitude toward reserve capacity:

“Although there have been recent controversies in Texas about the low cost of natural gas keeping prices too low to incentivize the construction of sufficient reserve capacity, it is to be expected that an efficient competitive market would have a different level of reserve capacity than an inefficient rate-regulated monopoly.”<sup>19</sup>

By this way of thinking, rolling blackouts and dire warnings about supply shortages should be considered features – not flaws – of an economically “efficient competitive market.” While such thinking might trouble an electric engineer – or the president of NRG Energy’s Gulf Coast Region – it seems perfectly appropriate to those whose support for retail competition stems from its *theoretical appeal* rather than its *practical implications*.

The Commission should not dismiss the very real supply shortages that have plagued competitive retail electric markets. The long-term planning conducted under the IRP process ensures that our state’s residents and businesses can count on an adequate supply of reliable energy developed under the policies approved by their elected regulators. It also

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<sup>14</sup> NRG CEO Admits Merchant Build “Virtually Impossible” in Any Market, Including Capacity Markets, as Texas Chair Nelson Says Capacity Market Warrants Exploration, EnergyChoiceMatters.com, August 9, 2013, <http://www.energychoicematters.com/stories/20130809j.html>

<sup>15</sup> Comments of Retail Competition Advocates and the Retail Energy Supply Association Addressing Retail Electric Competition Issues, at page 29

<sup>16</sup> Comments of Tucson Electric Power Company and UNS Electric, Inc., at pages 7-8

<sup>17</sup> Comments of the National Energy Marketers Association, at page 6.

<sup>18</sup> Fuguay, Jim, *Texas increases its lead in wind power*, Star-Telegram (Fort Worth), April 11, 2013, <http://www.star-telegram.com/2013/04/11/4769169/texas-increases-its-lead-in-wind.html>

<sup>19</sup> Goldwater Institute and Roy Miller’s Comments, Attachment 2, Policy Brief No. 259, at page 3

allows the ACC to oversee the development of an appropriately balanced resource mix while ensuring that transmission lines and generating plants are developed where they are most needed, not just where they might be more conveniently built.

If the Commission moves forward with retail competition, “planning would be decentralized and determined by market players in developing their competitive strategies based on their available capital and niche knowledge.”<sup>20</sup> And if market players decide not to risk their available capital to develop the resources needed to serve the peak of our state’s energy demand curve, then Arizona residents will have to settle for the cold comfort of free market theory instead of cool, conditioned air on our hottest summer days.

### **Underestimating Transition Issues**

Those urging the Commission to exchange our proven regulatory system for a newly created competitive retail electric market consistently underestimate the time, cost and complications of that task. Many restructured states are still writing rules, imposing new fees and litigating before the Federal Energy Regulatory Commission (“FERC”) more than a decade after launching competitive retail electric markets. Supporters also overlook legal and operational obstacles to such a transition here and, in some cases, misstate details from Arizona’s previous history with retail competition.

The Goldwater Institute, for example, claims the Commission needn’t engage in the long, contested process of establishing which long-term utility investments should be recouped on an accelerated basis because these “stranded costs” have already been recovered.<sup>21</sup> But the stranded cost settlements reached during Arizona’s previous consideration of retail competition in the late 1990s obviously did not reflect any costs incurred since then. As noted in the Companies’ initial comments, TEP estimates that it would seek accelerated recovery of at least \$500 million in such costs in a transition to a competitive retail electric market.

Advocates also underestimate the cost of preparing our grid for retail electric competition. Unlike other states with restructured markets, Arizona lacks an established ISO or RTO to manage a centralized transmission and energy market in a restructured system. While many proponents acknowledged the need for such an entity in a competitive retail market here, none volunteered details about how much it would cost or how much time it would take to set one up – a significant oversight, given the scope of this task. Customers served by the multistate Midwest ISO (“MISO”) incurred a \$245 million cost to create its real-time and day-ahead energy markets in 2005 and another \$71 million to launch its ancillary markets four years later.<sup>22</sup> They also must cover MISO’s annual \$250 million operating

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<sup>20</sup> Goldwater Institute and Roy Miller’s Comments, at page 19, lines 7-9

<sup>21</sup> Goldwater Institute and Roy Miller’s Comments at page 8, lines 25.5-26.5

<sup>22</sup> EAI Data Request Response to Arkansas Electric Cooperation Corporation’s 3<sup>rd</sup> Set, June 16, 2011, [http://www.apscservices.info/pdf/10/10-011-u\\_449\\_1.pdf](http://www.apscservices.info/pdf/10/10-011-u_449_1.pdf)

budget.<sup>23</sup> While the cost of setting up and running a smaller, Arizona-only ISO could be lower, the expense would greatly exceed the economic benefits customers could expect to realize through its operations.

As an alternative, some proponents suggest that Arizona could join the California ISO ("CAISO"). Again, though, they fail to disclose the cost or consequences of such a move. Entergy, an electric utility serving 2.8 million customers in Arkansas, Louisiana, Mississippi and Texas, estimates it will spend approximately \$100 million to join MISO this year while incurring \$195 million in administrative expenses over the next 10 years.<sup>24</sup> In return, Entergy hopes to realize more than \$1 billion in net benefits for its customers by gaining new access to lower cost energy resources and markets. Arizona customers, though, could not expect comparable benefits by joining CAISO. Indeed, such a transaction would link Arizona's low cost energy resources to the high priced California energy market under the direction of a quasi-governmental organization dominated by California interests. The predictable result would be an increase in energy costs borne by Arizona customers, to the benefit of our neighbors to the west. Indeed, the CAISO might well order construction of new transmission links between our two states, obliging Arizona customers to pay our "fair" share of costly new infrastructure that would serve to equalize energy costs between Arizona and California – increasing rates here. Arizona customers also could be affected by rules set by the California legislature and the California Energy Commission ("CEC"), including potential charges linked to carbon dioxide emission restrictions.<sup>25</sup>

Finally, some proponents suggest that the Arizona Independent Scheduling Administrator's Association ("AZISA") – a non-profit entity with one employee and a \$121,000 annual budget – could stand in for an ISO or RTO in a competitive retail electric market. Vicki Sandler, AZISA's Executive Director, filed comments claiming that competitive transactions for up to 300 megawatts ("MW") "could take place immediately" and suggesting that the entity's existing protocols could govern a competitive retail market "with some fine tuning."<sup>26</sup> Yet any such competitive transactions would require changes to current rates for TEP and APS that were established in settlement agreements. This would require that new rate cases be litigated for each utility, a time consuming process. Moreover, since the *Phelps Dodge* ruling overturned key components of Arizona's competition rules, it has been clear

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<sup>23</sup> MISO 2012 Operating and Capital Budget, Page 5 (Available online at <https://www.misoenergy.org/Library/Repository/Meeting%20Material/Stakeholder/BOD/BOD/2011/20111208/20111208%20BOD%20Item%2006%20%20VI.A%202012%20Budget%20Public%20Final.pdf>)

<sup>24</sup> *An Evaluation of the Alternative Transmission Arrangements Available to the Entergy Operating Companies and Support for Proposal to Join MISO*, May 12, 2011, [http://entergy.com/futurepower/pdf/Evaluation\\_Report.pdf](http://entergy.com/futurepower/pdf/Evaluation_Report.pdf)

<sup>25</sup> The potential loss of control associated with joining an ISO was a decisive factor in the Virginia State Corporation Commission's 2003 recommendation to pause the implementation of retail competition, leading to its ultimate repeal by the legislature in 2007. "The continued lack of current and expected market activity leads directly to our recommendation that the Act be suspended in order to preserve Virginia's authority. It is in the public interest to avoid ceding jurisdiction over transmission, generation, reliability and, ultimately, the cost of power, to federal regulators and regional entities. The likelihood that increased prices may be required to foster competition and uncertainty regarding Federal direction with regard to RTOs poses additional uncertainty as to what will occur when capped rates end on July 1, 2007." [http://www.scc.virginia.gov/comm/reports/2003\\_1.pdf](http://www.scc.virginia.gov/comm/reports/2003_1.pdf) at Page xii.

<sup>26</sup> Comments of the Arizona Independent Scheduling Administrator's Association ("AZISA") at page 2

that the Commission would need to draft new rules to govern competitive energy sales – a contested process that would take years to complete. It also is clear that AZISA and its protocols would need a bit more than a tune-up to manage a fully competitive retail electric market in Arizona. In light of MISO’s \$245 million startup costs and \$250 million annual operating budget, the cost estimates proposed in Sandler’s comments for either a “streamlined” or full-scale ASIZA – startup costs of \$10,000 to \$3.9 million and an annual operating budget of \$1 million to \$16 million – would not cover the full scope of operations for the FERC-approved RTO or ISO that would be required for a competitive retail market.

### **Overlooking Legal Obstacles**

Supporters of competition offer varying opinions about the impact of the *Phelps Dodge* decision. Some say the Commission can sweep away the obstacles posed by that ruling merely by uttering a few magic words. Another suggests that *Phelps Dodge* has been effectively overturned by the courts. In our view, the hurdles erected by that ruling still stand as significant obstacles to any future restructuring of Arizona’s electric market. The Companies join in the analysis of APS, SRP and the electric cooperatives of these issues.

Moreover, the *Phelps Dodge* decision is not the only legal hurdle to the potential restructuring of Arizona’s electric market. Constitutional and statutory prohibitions against discrimination could complicate such a transition, as could questions about the Commission’s authority to require a public service corporation to serve as a provider of last resort of a “competitive service.” The Commission also must be careful to avoid creating any “takings” by denying utilities an opportunity to fully recover all “stranded costs,” an issue addressed more fully above.

Given these potential obstacles and the conflicting interpretations of stakeholders, it seems likely that any decision to create a competitive retail electric market here would result in costly, time-consuming litigation. That, in turn, could undermine the stability of our state’s regulatory climate, reducing investor confidence and possibly increasing the Companies’ cost to access capital markets for necessary infrastructure investments. The prospect of such expense and uncertainty cannot be justified in light of the safe, reliable and relatively inexpensive electric service that Arizona residents and businesses enjoy today.

### **To Choose, We Lose**

Virtually every supporter of retail electric competition cited choice itself as a key benefit of restructuring. Many went even further, suggesting that the success of competitive markets could be judged merely by the number of choices available to consumers or how many consumers have chosen providers other than their incumbent utility.<sup>27</sup> For prospective providers, of course, such metrics make sense. But for consumers, the true value of choosing obviously depends on the quality of the available choices. In Arizona, the options offered in a competitive retail electric market could not match the value customers realize through the low rates, high reliability and transparent rules of Arizona’s current regulatory system.

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<sup>27</sup> Comments of the Retail Competition Advocates and Retail Energy Supply Association comments at page 5

Advocates also overlook the multitude of choices available to customers served by the Companies and other regulated Arizona utilities. Our customers can choose time-of-use rates, fixed price plans, "green" energy alternatives and incentives for energy efficiency and renewable power without forgoing the consumer protections offered in our regulated system. The Federal Trade Commission devotes several pages of its comments to the failings of "flat" rates and the virtues of time-of-use rates and special electric vehicle rates – never once mentioning that Arizona utility customers already have such options.<sup>28</sup> Under our current system, the Commission can ensure that regulated utilities offer enough options to suit discriminating consumers without forcing all customers to thoroughly review every available option to avoid being overcharged for electric service.

Advocates appear to believe that choice, not savings for customers, is the most important factor to be considered. In their comments, the Retail Competition Advocates and the Retail Energy Supply Association included a table showing the variety of rate options available to customers in certain states. Yet many of those options were above the price those customers were currently paying. For example, the data showed that any residential customer in New Jersey who switched to a competitive supplier would see a price increase of between 6 and 49 percent.<sup>29</sup> While it's easy to see how such choices benefit suppliers, it's harder to understand how paying more for the same commodity could benefit customers.

Some retail competition advocates seem committed to ensuring that default service is as unattractive as possible. Although incumbent utilities are often tasked with serving as the Provider of Last Resort ("POLR") for residential customers and others who haven't chosen competitive providers, the FTC recommends that they not be allowed to provide service at prices made possible by balanced generation portfolios and responsibly hedged procurement contracts:

"The ACC can also help avoid impeding entry by pricing POLR service to follow wholesale power prices closely. If POLR prices are hedged through extensive laddering of procurement contracts (procuring POLR supplies through a portfolio of contracts of varying durations), competition may be ineffective."<sup>30</sup>

The laddering strategy employed by traditional utilities provides price stability for customers, a chief benefit of our current system. Yet the FTC recommends that the Commission deny this benefit to the most vulnerable customers in a restructured market, forcing them to face volatile market-based prices for the purpose of driving business to alternative providers.

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<sup>28</sup> Comments of the Staff of the Federal Trade Commission, at pages 4-6

<sup>29</sup> Retail Competition Advocates and Retail Energy Supply Association comments, at page 8

<sup>30</sup> Comments of the Staff of the Federal Trade Commission, at page 19. In a footnote to this comment, the FTC says competing against stable utility style rates "creates a boom and bust cycle for retail marketers."

Such rules help explain why it's prospective providers, not customers, who are clamoring for more "choice" in Arizona's electric market. While competitive providers would be able to choose the customers they would seek to serve in our state, incumbent utilities would likely have no option but to serve as Provider of Last Resort for residential customers and others whose relatively modest, peaking load profiles might not attract competitive offers worth choosing. Meanwhile, Arizona residents and businesses would no longer have access to what would surely be their most beneficial choice: the reliable value provided by regulated cost of service rates.

### **Don't Mess with Texas**

Rules that encourage customers to choose competitive providers are among the reasons cited by competition advocates – including NRG, Ambit, Wal-Mart Stores and the Goldwater Institute – who recommend Texas as the best model for a restructured Arizona market. They neglect to mention that, unlike Texas – where grid oversight falls to the Electric Reliability Council of Texas – Arizona would necessarily cede authority to the FERC in a competitive retail electric market. The suggestion also steers the Commission toward a system that has featured volatile rates, diminished energy reserves and a dramatic increase in customer complaints.

The Texas Coalition for Affordable Power, a non-profit group that buys energy for municipal customers, published a thorough report on the history of retail competition in Texas in December 2012 that included the following findings:

- Residential electric rates increased in areas of Texas where retail competition was launched in 2002, boosting the state's traditionally low electric bills above the national average. While rates have since fallen, customers in those areas would have saved \$10.4 billion between 2002 and 2012 if their rates had merely tracked the national average.
- During that same period, average residential rates in deregulated areas of Texas have been anywhere from 9 to 46 percent higher than average residential rates in areas that remained under traditional regulation.
- Rising natural gas prices had a greater impact on rates in areas served by competitive electric providers. Between 2002 and 2010, when natural gas costs increased 35 percent, Texas' competitive power providers increased their average residential rates by 53 percent. By contrast, the rates paid by residential customers in traditionally regulated areas of Texas increased just 31 percent.
- Under the rules that govern the states' competitive wholesale energy sales, "the economic benefit of producing cheap electricity mostly has ended up in the pockets of generators as extra profits, not in the pockets of consumers as savings."
- Texas, which once had the highest generation reserve margins in the nation, now has among the lowest, causing "serious reliability challenges for the state's power grid."
- There have been two statewide rolling blackouts in four years under the restructured system as well as numerous "reliability emergencies," including nine in

2011. By contrast, the Electric Reliability Council of Texas ("ERCOT") ordered statewide rolling blackouts only once in three decades before restructuring.

- Retail competition has prompted more than an eight-fold increase in customer complaints to the Public Utility Commission of Texas. The average number of electricity related complaints increased from about 1,300 per year before deregulation to more than 11,400 afterward.

Complaints about Texas power providers are widespread. Even a cursory review of TexasElectricityRatings.com, a website where customers share stories about their experiences in the competitive Texas electricity market, reveals significant customer dissatisfaction about pricing, service, and marketing tactics.<sup>31</sup>

It would be unfair to say the Texas restructuring model produces no benefits. The fact that many of the competitive providers responsible for such results are encouraging use of a similar system here suggests the Texas model generates attractive results for energy companies. For customers, though, the results of retail competition in Texas range from disappointing to potentially disastrous.

### **No Place like Home**

In truth, no state with a restructured energy market offers a better combination of price, reliability and value than Arizona's current traditional utility regulatory model. If the residents of those states had the option to select what Arizona customers already enjoy – low rates and high reliability from civic-minded local companies with solid customer satisfaction ratings – their choice would be very easy indeed.

The same could be said of the Commission's decision in this docket. Supporters of retail electric competition have not provided clear or convincing evidence that customers would realize any benefits from such a system here. On the contrary, such a system would expose customers to higher costs, increased price volatility, capacity shortages, customer confusion, market manipulation and a loss of state regulatory oversight.

The arguments in favor of retail competition are not so different now than they were more than a decade ago, when the Commission last considered them. Since then, though, we have seen how the system's theoretical benefits have, in practice, been overwhelmed by its pragmatic failings. Most glaringly, the imperfect, "competitive" marketplaces in restructured states have proven they're not up to the task of replacing the Commission's IRP process. When regulated utilities are not clearly assigned responsibility for maintaining adequate and diverse supply of generating resources, it turns out that those supplies usually don't get built. This fatal flaw, combined with the other costs and consequences

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<sup>31</sup> Reviews for three companies filing comments in this docket can be found at: <http://www.texaselectricityratings.com/read-reviews/entrust-energy>, <http://www.texaselectricityratings.com/read-reviews/ambit-energy>, and <http://www.texaselectricityratings.com/read-reviews/direct-energy>

faced by other restructured states, has confirmed the wisdom of Commission's previous decision to halt a transition to a competitive retail electric market.

In the face of all the potentially adverse impacts to customers, TEP and UNS Electric once again urge the Commission to definitively halt its consideration of retail electric competition and find that such restructuring would not serve the best interests of Arizona residents and businesses.